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Sunday, March 31, 2002

In re
SULLIVAN & LODGE, No. 99-10501
Debtor(s).
_____/

Memorandum on Motion For Reconsideration

I. Introduction

The law firm of Lieff, Cabraser, Heimann & Bernstein, LLP, former special counsel to the debtor (hereinafter "Counsel"), has asked the court to reconsider its order denying compensation and vacating its employment order. The court has reviewed the voluminous material filed in support of this motion and sees no basis for changing its mind.

The court made its ruling on two grounds. First, it found that Counsel had violated Rule 3-310(C) of the California Rules of Professional Conduct by failing to obtain the informed written consent of debtor Sullivan & Lodge before commencing a class action on behalf of others after being retained to represent Sullivan & Lodge in an action against the same defendants. Second, the court found that Counsel should have disclosed this connection when they applied for an order authorizing their employment. The court still feels that both of these omissions require forfeiture of all fees.

II. Failure to Obtain Written Consent

Counsel make two arguments in support of their request that the court reconsider its finding that it violated Rule 310(C). First, they argue that as a matter of law the rule does not apply to separate lawsuits. The court simply disagrees with this analysis. Counsel commenced the class action on the basis of information they learned from Sullivan & Lodge. The substance of the two suits - that the defendants were selling water as "spring water" when it was not - was

the same in both cases. The court concluded that as a matter of law the two lawsuits had enough commonality to make Rule 310(C) clearly applicable.

Upon further research, the court has found no basis for the narrow definition of "matter" urged by Counsel. While case law on the issue is not extensive, all cases the court has found interpret the term expansively when applied to ethical issues. For instance, in General Motors Corp. v. City of New York, 501 F.2d 639, 650 (2nd Cir. 1974), an attorney who had worked for the Justice Department and had filed a case against GM for violation of the Sherman Anti-Trust Act in 1956, was found to be disqualified from representing, as a private attorney on a contingency basis, 200-300 readily identifiable non-federal governmental units of the city of New York in a private antitrust suit by the City of New York against GM, some 14 years later. The court found that from an examination of the complaints the City's antitrust action was sufficiently similar to the 1956 case to be the same "matter" under the applicable rule of professional conduct. Despite the passage of fourteen years, the court found that where "the overlap of issues is so plain" the two separate actions must be considered the same matter. 501 F.2d at 652. In this case, the overlap of issues in the action on behalf of Sullivan & Lodge and the class action are plain and compel a conclusion that for ethical purposes the two actions are the same matter.

The citing by Counsel of Miller v. Alagna, 138 F.Supp.2d 1252, 1256-7 (C.D.Cal.2000), is somewhat disingenuous. In the course of ordering the disqualification of an attorney, the court did state that "[u]nder the California Rule, a potential conflict of interest giving rise to the obligation to obtain informed written consent exists whenever an attorney represents more than one client in the same lawsuit." The court did not determine, as Counsel imply, that the rule can be violated only in the same lawsuit. Indeed, District Judge Timlin would probably not be pleased that his statement has been cited as standing for a narrow interpretation of the ethical rule.

Second, Counsel argue that Sullivan & Lodge knew all about the class action and knew that they had "the authority to terminate Special Counsel had they truly believed the dual representation was inconsistent with their interests." This argument misses the point of Rule 310(C). Sullivan & Lodge were not told that they had the right to keep their counsel from also representing the class. Had they known this, they could have made the informed decision called for by the rule.

III. Failure to Disclose

Counsel seeking court approval of its employment has a duty to come forward with all facts which might bear upon its duty of undivided loyalty to the estate. In re Park-Helena Corp., 63 F.3d 877, 881 (9th Cir. 1995). Disclosure must include representation of other co-litigants, even if the dual representation does not rise to the level of an actual conflict of interest. In re B.E.S. Concrete Products, Inc., 93 B.R. 228, 235-6 (Bkrtcy.E.D.Cal.1988).

Counsel argue that their dual representation came out in various court hearings, and that this was an adequate substitute for full and proper disclosure in their employment application. The court simply disagrees. The issue of adequate disclosure was not before the court when other matters were discussed, nor did the court recall what was and was not disclosed in

Counsel's employment application. The fact that the connections came to light in the course of other business does not excuse the fact that the application was false. As the court noted in In re B.E.S. Concrete, 93 B.R. at 236-7:

The disclosures must appear in the application and declaration required by Bankruptcy Rule 2014(a). It is not sufficient that the information might be mined from petitions, schedules, section 341 meeting testimony, or other sources. In re Haldeman Pipe & Supply Co., 417 F.2d at 1304; In re Automend, 85 B.R. 173, 178 (Bankr.N.D.Ga.1988); In re Flying E Ranch, 81 B.R. 633, 637 (Bankr.D.Colo.1988).

IV. Actual Conflict

Counsel take exception to the court's expressed belief that Sullivan & Lodge would have fared better had Counsel dedicated themselves solely to Sullivan & Lodge and not created the class action. The court responds to this argument by first noting that it is not necessary to the court's conclusions and not meant to be so. Rule 310(C) applies to potential conflicts. The potential conflicts in this case were that defendants might try to gain leverage in one case by offering an enticing settlement in the other and that defendants might not have the financial ability to satisfy two large judgments against it. No finding of actual conflict is necessary in order to make Rule 310(C) applicable.

Nonetheless, the court still feels strongly that Sullivan & Lodge would have fared better had Counsel given them their sole attention and loyalty, although this conclusion is admittedly a subjective one. Counsel have developed a substantial reputation over the years, and their firm probably qualifies as a corporate defendant's worst nightmare. The intangible effect of this firm's representation of Sullivan & Lodge would have been much stronger if not diluted by representation of the class. The defendants might well have concluded that Sullivan & Lodge's action was a sideshow to Counsel and not the primary focus of their efforts, especially since they filed the class action first.

V. Venal Nature of Class Actions

Counsel also argue that the court's "apparent personal belief" in the venal nature of class actions is untrue and unsupported. However, this court is hardly the first to note the ethical problems which arise when the law firm is essentially the plaintiff. A computer search of "class actions" and "ethics" in the same sentence yields hundreds of results, of which the following is typical:

[C]lass actions have been repeatedly criticized for allowing class attorneys to appropriate more than their rightful and efficient share of the common fund and for providing much less compensation and deterrence than alleged. [FN5] Lawyers' gain has often come at the price of class members' loss. Misalignment of interests, it has been claimed, has resulted in absurdly low compensation for class members, and at the same time class action attorneys' fees have soared. [FN6] Courts have repeatedly failed to guarantee class members their rights and have kept approving collusive settlements that award class members mere coupons while providing attorneys with large monetary fees. [FN7] Named representative plaintiffs have proven to be merely figureheads: ineffective, passive, unsophisticated, and

completely disregarded by both courts and class attorneys. [FN8] Class actions have thus reached what seems to many a dead end. Lawyers are instrumental to the success of private law enforcement, yet any such success results in bigger feasts for lawyers, leaving class members with mere scraps and leftovers. [FN9] The self-appointed guardians are allegedly giving too much consideration to their self-interest and too little attention to their duties as guardians.

Klement, "Who Should Guard the Guardians? A New Approach For Monitoring Class Action Lawyers," 21 Rev.Litig. 25, 25 (2002). It hardly takes a law degree to smell something foul when the "plaintiffs" in a class action are a former employee of counsel and a friend of their bookkeeper.

VI. Mitigation

In its original decision, the court concluded that Counsel had intentionally omitted disclosure of the class action in their employment application so that they would not risk losing their chance at the potentially lucrative class action fees. The court still feels entirely justified in drawing this inference from all the facts and circumstances. However, the attorney who signed the disclosure declaration - who had not appeared at the first hearing - has now come forward and denies any such intent.

Giving due deference to the word of an attorney for whom the court has long held respect, the court still cannot see its way to allowing Counsel any fees from the bankruptcy estate. Regardless of his intent, he was no newcomer to the legal profession and should have known the importance of a declaration filed under penalty of perjury. If he did not fully understand the purpose of the disclosure declaration, he should have made inquiry. He should not have relied upon anyone else to draft a declaration for him, and he should have erred on the side of full disclosure. He failed to do these things, and as a result he left the court with the feeling that it had been duped into approving Counsel's employment.

VII. Conclusion

Despite potential conflicts, Counsel never obtained the informed consent of Sullivan & Lodge before they created and brought a class action based on information brought to it by Sullivan & Lodge. The two actions were intimately related, making Rule 310(C) of the California Rules of Professional Conduct applicable. Counsel violated the rule, and accordingly deserve no fees.

In addition, Counsel failed to disclose their dual representation to the court. Mentioning the connection in the course of other matters does not substitute for proper disclosure. The court would not have approved Counsel's employment had it know all of the facts. Accordingly, the order authorizing their employment must be vacated and Counsel may not receive any fees.

For the foregoing reasons, Counsel's motion for reconsideration will be denied. The attorney for Sullivan & Lodge shall submit an appropriate form of order.

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